

Client Update

NAIC Begins to Develop a Group Capital Measure for U.S. Insurance Enterprises

NEW YORK

Eric R. Dinallo
edinallo@debevoise.com

Ethan T. James
etjames@debevoise.com

Thomas M. Kelly
tmkelly@debevoise.com

Gregory J. Lyons
gjlyons@debevoise.com

Nicholas F. Potter
nfpotter@debevoise.com

John M. Vasily
jmvasily@debevoise.com

Samuel E. Proctor
seproctor@debevoise.com

LONDON

Jeremy G. Hill
jhill@debevoise.com

James C. Scoville
jcscoville@debevoise.com

Benjamin J. Lyon
blyon@debevoise.com

Edite Ligere
eligere@debevoise.com

FRANKFURT

Dr. Peter Wand
pwand@debevoise.com

HONG KONG

E. Drew Dutton
eddutton@debevoise.com

Stuart J. Valentine
sjvalentine@debevoise.com

On July 23, 2015, the National Association of Insurance Commissioners (the “NAIC”) ComFrame Development and Analysis (G) Working Group released a Discussion Draft on Approaches to a Group Capital Calculation. In the Discussion Draft, and a conference call on July 30, 2015, the Working Group made clear that it has determined to develop an NAIC capital measure for U.S. insurance groups and does not intend to limit its role to providing input to the ongoing efforts by U.S. federal and international regulators to construct such measures.

The Discussion Draft follows the Working Group’s November 16, 2014 U.S. Group Capital Methodology Concepts Discussion Paper, which presented two potential group capital methodologies for U.S. internationally active insurance groups (“IAIGs”): a risk-based capital (“RBC”) approach and a cash flow approach.¹ Like the November 2014 Paper, the Discussion Draft is brief. It provides a high-level overview of three group capital methodologies, including variations of each, and describes the pros and cons for each option. The Discussion Draft abandons the cash flow option set forth in the November 2014 Paper, focusing on three different RBC-based approaches, although the NAIC explicitly reserves the option in the Discussion Draft to consider alternative approaches in the future.

The three approaches set forth in the Discussion Draft are:

- The RBC Aggregation approach, which would aggregate existing regulatory capital requirements for all entities within an insurance group’s holding company structure, and thus, would require the creation of a standard for

¹ For a copy of the NAIC’s U.S. Group Capital Methodology Concepts Discussion Paper, please see http://www.naic.org/documents/committees_g_cfwg_exposure_disc_paper_us_grp_cap_method_concepts.pdf.

any legal entities without existing capital requirements. The Discussion Draft identifies two potential variations to the general approach, which would instead require (1) non-U.S. insurance legal entities to submit information for use in RBC calculation, and (2) all entities, including those without existing capital requirements, to submit information for purposes of the aggregate calculation.

- The SAP Consolidated Filing for RBC approach, which would establish consolidated accounting rules for statutory accounting principles (“SAP”) and use of consolidated financial statements in the RBC formula. Potential variations include (1) limiting SAP consolidation to insurance legal entities and using an aggregation approach for non-insurance entities and (2) adjusting RBC to utilize more going-concern confidence levels and time horizons.
- The GAAP Consolidated Filing for RBC-Plus approach, which would leverage existing consolidated financial statements based on generally accepted accounting principles (“GAAP”) to establish a group RBC formula that has been adjusted to reflect additional going-concern confidence levels and time horizons. A potential variation uses unadjusted RBC, reflecting more of a “gone concern” outlook. The Discussion Draft notes that this approach does not address insurance groups that do not currently prepare GAAP-based financial statements.

On July 30, 2015, the NAIC held a conference call and took comments on the Discussion Draft. During the call, when asked why the NAIC had decided to develop its own capital measure, instead of focusing its efforts on contributing to ongoing work by the Federal Reserve and the International Association of Insurance Supervisors (“IAIS”) on group capital issues, NAIC representatives emphasized a need to stay “ahead of the curve” and to maintain credibility in international and other fora as the Federal Reserve, IAIS and others continue to move forward on group capital frameworks for insurance enterprises.

IMPLICATIONS

The Working Group’s decision to begin developing a U.S. group capital measure was not broadly expected. As discussed above, the release of the Discussion Draft at a minimum suggests continued pressure on the NAIC to explore group capital standards for U.S. insurers.

In addition, the high-level nature of the Discussion Draft means that a host of questions regarding implementation and administration of a group-wide capital standard remain unanswered. For example, the timeline for development and implementation of, and the authority for U.S. states to implement, such a

standard remain unclear. Additionally, the Discussion Draft does not explain how the proposed standards would interact with other capital requirements applicable to U.S. insurance groups, including, consolidated capital standards to be established by the Federal Reserve for the insurance groups under its supervision. Finally, the scope of insurance groups to which the standard would apply remains unclear. While the November 2014 Paper addressed capital standards only for U.S. IAIGs, a subset limited to the larger and more internationally active groups, the Discussion Draft is directed more broadly towards “U.S. Insurance Groups.”

The Working Group will discuss the Discussion Draft on Saturday, August 15, 2015 at the NAIC 2015 Summer National Meeting in Chicago, IL.

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Please do not hesitate to contact us with any questions.